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Summary of the Jobs and Growth Tax Relief Reconciliation Act of 2003

2004 EDITION

Hoffman / Smith / Willis / Raabe / Maloney

Prepared by William H. Hoffman Jr.

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William H. Hoffman, Jr., J.D., Ph.D., CPA
University of Houston

James E. Smith, Ph.D., CPA
College of William and Mary

Eugene Willis, Ph.D., CPA
University of Illinois at Urbana

William A. Raabe, Ph.D., CPA
Ohio State University

David M. Maloney, Ph.D., CPA
University of Virginia

Prepared by

William H. Hoffman, Jr., J.D., Ph.D., CPA
University of Houston

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William H. Hoffman Jr., James E. Smith, Eugene Willis, William A. Raabe, David M. Maloney

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Printer:
Thomson West
Eagan, MN

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Printed in the United States of America
1 2 3 4 5 6 07 06 05 04 03

ISBN: 0-324-22681-0

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SUMMARY OF THE JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003

On May 28, 2003, President Bush signed into law the third largest tax cut in U.S. history. Known as the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), the legislation passed Congress by a narrow margin. In the Senate the Act passed by 51 to 50, with Vice-President Cheney casting the tiebreaking vote.

When considering a tax bill, Congress is required to estimate the impact of the legislation on revenue over a 10-year window. Proponents of JGTRRA project that the tax cut will cost $350 billion in lost revenue over the 10-year period. Those opposed to the legislation estimate the loss at more like $810 billion. According to this view the more modest revenue loss is arrived at by the use, on an unprecedented scale, of budget and accounting gimmicks. In truth, making many of the relief provisions temporary in duration controls the amount of the revenue loss that must be reported. Thus, under numerous "sunset" provisions, several key benefits are scheduled to expire at the end of 2004. Since 2004 happens to be an election year, there will be pressure for extending these benefits. After all, many taxpayers regard the failure to continue an expiring tax benefit as being akin to enacting a new tax increase. No legislator wants the stigma of being an advocate of a "tax increase."

As the name indicates, JGTRRA is intended to generate job growth. Proponents of the legislation believe that tax cuts boost consumer disposable income and this, in turn, increases spending. The Act encourages additional capital investment by businesses by allowing more liberal tax write-offs of business equipment. Opponents of JGTRRA contend that the economy does not need this type of stimulus. Even worse, they argue, the tax cuts unduly favor the higher income investor class and offer little relief for the rank-and-file wage earner.

Furthermore, opponents expect, JGTRRA to generate large budget deficits, which will aggravate an already serious national debt problem.

JGTRRA's key components are summarized as follows:

- Reduces the maximum rate on net capital gain from 20% to 15% for taxpayers in the top four brackets (25%, 28%, 33%, and 35%). For taxpayers in the bottom two brackets (10% and 15%), the maximum rate on net capital gain drops from 10% to 5%. This change expires (sunsets) on December 31, 2008.

- Reduces the tax rate on qualifying dividends. Prior to JGTRRA, dividends were taxed at ordinary income rates. The tax rate on dividends becomes the same as that on net capital gain (i.e., a 15% rate applies to taxpayers in the top four tax brackets and a 5% rate applies to taxpayers in the bottom two brackets). This change also sunsets on December 31, 2008.

- Accelerates the tax rate reductions that were scheduled to be phased in by 2006 under RRA of 2001 to the current year. Thus, the rate brackets become 10%, 15%, 25%, 28%,

33%, and 35%. For the top four brackets, this is a drop from 27%, 30%, 35%, and 38.5%. As this change is to be permanent, there is no sunset provision.

- Alleviates the problem of the marriage penalty. JGTRRA expands the reach of the 15% bracket and increases the amount of the standard deduction available to married persons. As was true of the rate reductions, this is an acceleration of a provision contained in RRA of 2001. Under JGTRRA, the change sunsets on December 31, 2004.

- Raises the child tax credit from $600 to $1,000 for 2003 and 2004. Based on data contained in the tax returns filed for 2002, the IRS is to begin sending advance payments to taxpayers in July of 2003. The JGTRRA increase sunsets on December 31, 2004.

- Boosts the amount allowed under § 179 for the immediate expensing of business equipment from $25,000 to $100,000. Effective January 1, 2003, the change sunsets on December 31, 2005.

- Expands the amount that can be deducted as bonus depreciation from 30% to 50%. The expansion is effective for original use property acquired after May 5, 2003, and sunsets on December 31, 2004.

- Raises the exemption for AMT purposes from $35,750 to $40,250 for single taxpayers and from $49,000 to $58,000 for married taxpayers. The larger exemptions are for 2003 and 2004 only, as the change sunsets on December 31, 2004.

Besides being a roller coaster of on and off changes between now and the next few years, JGTRRA is unique in several respects. First and foremost, it contains no revenue offsets (i.e., tax increases). In this regard, it flaunts the notion of revenue neutrality. Although many revenue enhancers were considered by Congress during the deliberation process, none were enacted. Perhaps some of these will reappear in future tax legislation.

Second, JGTRRA emerged as a relatively clean and uncluttered piece of legislation. In the rush toward passage, congressional managers were able to ward off the usual special-interest side provisions that get attached to major tax bills. In the least, therefore, JGTRRA is direct and to the point. Except for the sunset provisions, it could even be categorized as being simple!

FORMAT

This supplement is specifically designed to accompany the following texts:

Hoffman, Smith, and Willis, *West Federal Taxation: Individual Income Taxes, 2004 Edition* (referred to as INDIVIDUAL TEXT).

Hoffman, Raabe, Smith, and Maloney, *West Federal Taxation: Corporations, Partnerships, Estates and Trusts, 2004 edition* (referred to as CORPORATIONS TEXT).

Willis, Hoffman, Maloney, and Raabe, *West Federal Taxation: Comprehensive Volume, 2004 Edition* (referred to as COMPREHENSIVE TEXT).

Smith, Raabe, Maloney and Willis, *West Federal Taxation: Taxation of Business Entities, 2004 Edition* (referred to as BUSINESS ENTITIES TEXT)

Raabe, Willis, Smith, and Maloney, *West Federal Taxation: Advanced Business Entity Taxation, 2004 Edition* (referred to as ADVANCED BUSINESS ENTITIES TEXT)

Smith, *West's Internal Revenue Code of 1986 and Treasury Regulations: Annotated and Selected, 2004 Edition* (referred to as CODE).

Capital Gain Rates

The principal thrust of President Bush's original tax reform package was the inequity of the double tax on corporate income. Corporate profits are taxed first at the corporate level and shareholders then pay tax on dividends they receive from the corporation. Changes in the rates applicable to net capital gain were not originally envisioned but arose as a side issue on the resolution of the dividend problem. The end product is a tax treatment of both net capital gain and dividends that is much the same.

For taxpayers in the top four brackets (25%, 28%, 33% and 35%), the top rate on net capital gain is lowered from 20% to 15%. For taxpayers who are in the two lowest brackets (15% and 10%), the rate drops from 10% to 5%. The new rates are effective for sales and exchanges on or after May 6, 2003, and also apply for AMT purposes. Under the sunset provision, the prior 20%/10% rates are reinstated after 2008.

The treatment of net short-term capital gain has not been changed; such gain is still taxed as ordinary income. Likewise, collectibles are still taxed at 28%, and the 25% rate continues for unrecaptured § 1250 gain.

The disparity between long-term and short-term capital gain rates places added importance on the holding period.

Example. Two taxpayers, Emily and Jacob, are in the maximum income tax bracket. In June 2003, each recognizes a $100,000 capital gain from the sale of stock. If Emily has held her stock for 11 months and Jacob's holding period is 13 months, the results are as follows:

	Tax
Emily (35% X $100,000)	$35,000
Jacob (15% X $100,000)	15,000

The two-month difference in the holding period generates an additional $20,000 in tax due to the extra 20% tax rate. Prior to JGTRRA, Emily's rate difference would have

been 18.6% (38.6% top bracket rate – 20% rate for net capital gain), a slightly lesser amount.

The new capital gain rates offer attractive possibilities for planning within the family unit.

Example. The Stewarts have four school-age children, all age 14 or older. On June 3, 2003, they give 1,000 shares of Grey Corporation stock to each child. The stock was acquired as an investment several years ago at a cost of $4 per share. On the date of the gift, the stock has a value of $22 per share. Each child sells the stock one month later for $22 per share. Presuming the children have no other income, the tax consequences to each are as follows:

Sale price (1,000 shares X $22)	$22,000
Basis (1,000 shares X $4)	(4,000)
Net capital gain	$18,000
Tax rate applicable (to 15% bracket taxpayers)	X 5%
Tax per child	$ 900

The total tax of $3,600 ($900 X 4) for the children is to be contrasted with what would have happened without the gift. Had the Stewarts sold the stock, the tax result would be calculated as follows:

Sale price (4,000 shares X $22)	$88,000
Basis (4,000 shares X $4)	(16,000)
Net capital gain	$72,000
Tax rate applicable	X 15%
Total tax	$10,800

Thus, the Stewart family saves $7,200 ($10,800 – $3,600) by shifting the gain to their children. [Note: In this case, the donors' holding period and basis carry over to the donees. Also, no taxable gift results due to the annual exclusion.]

The new rates apply to the gains from the sale of capital assets that are "taken into account" after May 5, 2003. This rule could offer a saving in the case of certain installment sales.

Example. Ethan sold land in 2001 on an installment basis (and did not elect out of § 453). The land was a capital asset that had been held longer than one year. Ethan's gross profit percentage is 40%, and he receives the final two installments of $100,000 each during 2003. If the payment due dates are February 1 and July 1, the following tax results:

February installment

$100,000 (installment) X 40% (gross profit percentage) = $40,000 gain X 20% (applicable capital gain rate before JGTRRA) = $8,000 tax

July installment

$100,000 (installment) X 40% (gross profit percentage) = $40,000 gain X 15% (applicable capital gain rate after JGTRRA) = $6,000 tax

The $2,000 tax savings ($8,000 – $6,000) highlights the impact of the JGTRRA change.

What happens to certain 5-year property which previously could enjoy 18%/8% treatment? As the 15%/5% result is more advantageous, the prior rule has been repealed. Should the sunset provision ever take effect, it is hoped that Congress will reinstate the 18%/8%.

Unfortunately for taxpayers, JGTRRA does nothing to increase the amount of net capital loss that can be deducted in any single year. Although many bills have been introduced in Congress that would raise the cap, the $3,000 annual limit remains unchanged.

INDIVIDUAL TEXT: pp. 3-32, 3-33, 16-21 to 16-26, 20-18.
CORPORATIONS TEXT: pp. 2-12, 2-39, 13-32.
COMPREHENSIVE TEXT: pp. 2-32, 13-25, 13-26, 16-12.
BUSINESS ENTITIES TEXT: pp. 3-28, 3-29, 7-16 to 7-22, 14-29.
CODE: §§ 1(h)(1) and 55(b)(3).

Dividends

In January 2003, President Bush announced his original tax cut proposal carrying a $776 billion price tag. A significant part of the cost of the package was attributable to the revenue loss that would occur from the complete elimination of any tax on dividend income. Proponents of this change argued that making dividends tax-free would influence corporate behavior by encouraging corporations to distribute more of their profits. Theoretically this would increase the value of dividend-paying stocks by making them more attractive to investors. That major corporations lag in dividend distributions can be shown by the fact that only 354 stocks in the S&P 500 pay dividends, and their average yield is 2.32%

The central theme of the original Bush proposal, however, was grounded on the basic inequity in the corporate form of doing business. Profits are taxed twice—once when earned by the corporation and again when distributed to the shareholders as dividends. By eliminating the tax on dividends, therefore, double taxation would be avoided.

Another solution to the double taxation of corporate income would have been to allow the corporation a deduction for these distributions. This alternative carries the additional advantage of placing equity financing on an even playing field with debt financing. Like interest paid on debt obligations, dividends paid on stock also would become deductible by the corporation. In terms of political feasibility, however, the choice of solutions should be clear. Providing corporations with a benefit (i.e., making dividends deductible)—as opposed to providing shareholder-investors with a benefit (i.e., making dividends nontaxable)—is bound to be less acceptable to the general public. As individuals generate more sympathy than corporations, the President opted for the solution that had a better chance of public support.

Besides being costly in terms of revenue loss, the original Bush proposal was highly complex. Corporations would have been required to separate profits that had been subject to tax from those that had not. Only distributions of the former would have been nontaxable to the shareholders. Otherwise what would have been intended as only a single layer of taxation could have been converted to no taxation at all.

Through the process of congressional compromise, a proposed zero tax rate on dividend income became a rate of 15% (5% for taxpayers in the bottom two brackets). Unlike the net capital gain provision, which uses the same rate, the dividend rule is made retroactive to the beginning of 2003. These provisions sunset on December 31, 2008. Strangely enough, the 5% portion of the rate change becomes 0% for all of 2008!

Code § 1(h)(11) as amended by JGTRRA refers to "dividends taxed as net capital gain." As mentioned previously, the net capital gains description deals with the way dividends will be taxed. By no means does it imply that there will be any fusion between these two classes of income. The netting of gains and losses from capital transactions will continue in the same manner as in pre-JGTRRA. Likewise, the determination of what is and is not a dividend will continue to be controlled by the relevant provisions of Subchapter C of the Code (e.g., §§ 301, 316).

The advantageous dividend tax rates allowed by JGTRRA apply only to "qualified dividends." To be a qualified dividend, the stock on which it is paid must have been held for more than 60 days during the 120-day period beginning 60 days before the ex-dividend date. This holding period rule parallels that applicable to corporations claiming the dividends received deduction [see § 246(c)].

> Example. In June 2003, Green Corporation pays a dividend of $1.50 on each share of its common stock. Madison and Daniel, two unrelated shareholders, own 1,000 shares of the stock. Consequently, each receives $1,500 (1,000 shares X $1.50). Assume Daniel satisfies the 60/120-day holding period rule, but Madison does not. The $1,500 Daniel receives is subject to preferential 15%/5% treatment. The $1,500 Madison receives, however, is not. Due to noncompliance with the holding period rule, it is not a "qualified dividend" and is taxed at ordinary income rates.

> Example. Assume the same facts as in the preceding example with the further stipulation that both Madison and Daniel are in the top 35% bracket. Consequently, Madison pays a tax of $525 (35% X $1,500) on her dividend, while Daniel pays a tax of $225 (15% X $1,500) on his. The $300 saving that Daniel enjoys underscores the advantages that JGTRRA provides regarding the taxation of "qualified dividend" income.

Dividends from certain foreign corporations can be qualified dividends. Included dividends are from those corporations that are eligible for the benefits of a comprehensive income tax treaty with the U.S. Also included are dividends from those foreign corporations whose stock is readily tradable on an established U.S. securities market.

Under § 163(d), individual taxpayers need investment income in order to offset investment interest. Will dividend income constitute such income? JGTRRA amends § 163(d)(4) to say that it will—but only if the taxpayer forgoes the benefits of 15%/5% treatment.

The changes made by JGTRRA to lessen the tax consequences of net capital gain and dividend income reinforce the inadvisability of funding retirement accounts with stock. Since § 401(k) plans and IRAs do not pay income taxes, the 15%/5% benefits are lost. Instead distributions from these plans at retirement (or other separation from service) are taxed at ordinary income rates.

The new tax-favored treatment of dividends will have a marked impact on many closely held corporations. Prior to JGTRRA, the motivation was to avoid paying dividends, as they were nondeductible to the corporation and fully taxed to the shareholders. Instead, corporate profits were bailed out in a manner that provided tax benefits to the corporation. Hence, liberal use was made of compensation, loan, and lease arrangements—as salaries, interest, and rent are deductible items. Now, a new variable is interjected. Who should benefit? Shareholders prefer dividends, because salaries, interest and rents are fully taxed. Corporations, however, would continue to favor the distributions that are deductible. The premium will be on a good mix of the two approaches. Besides being attractive to the shareholders, the payment of dividends helps the corporation ease the problems of unreasonable compensation, thin capitalization, and meeting the arm's length test as to rents.

INDIVIDUAL TEXT: pp. 1-28, 4-15, 10-15 to 10-17, 20-18, 20-20, 20-22, 20-35.
CORPORATIONS TEXT: pp. 1-6, 2-4, 2-31, 2-38, 3-16 to 3-18, 4-2, 4-13, 6-11, 6-21, 13-8 to 13-16.
COMPREHENSIVE TEXT: pp. 1-28, 3-14, 9-16, 16-4 to 16-16, 16-31, 16-33, 17-16 to 17-18, 18-3, 18-15.
BUSINESS ENTITIES TEXT: pp. 1-2, 3-15, 3-16, 6-5, 9-2, 9-3, 9-15 to 9-20, 9-23 to 9-25, 14-8 to 14-14, 14-18, 14-19, 14-29, 15-41, 15-44.
ADVANCED BUSINESS ENTITIES TEXT: pp. 3-2, 3-3, 3-17, 3-18.
CODE: §§ 1(h)(11) and 301(f)(4).

Tax Rates

JGTRRA accelerates to the current year two phase-ins provided for by RRA of 2001 that relate to the income tax rates. The top four brackets, currently 27%, 30%, 35% and 38.6% are reduced to 25%, 28%, 33% and 35%. This was scheduled to occur, on a phase-in basis, by 2006. Except for the top percentage, which drops 3.6%, the change drops each bracket by 2%.

RRA of 2001 had also provided that the 10% bracket be expanded in 2008. The expansion was to be by $1,000 (from $6,000 to $7,000) for single taxpayers and by $2,000 (from $12,000 to $14,000) for married taxpayers filing jointly. The net effect of the change would be to save single taxpayers $50 ($1,000 taxed at 10% instead of 15%) and married taxpayers $100 ($2,000 taxed at 10% instead of 15%). JGTRRA accelerates this change so as to take effect in 2003. See Appendix A of this Supplement for the Tax Rate Schedules as revised by JGTRRA.

INDIVIDUAL TEXT: p. 3-18, Appendix A, front inside cover.
CORPORATIONS TEXT: p. 2-31, Appendix A.
COMPREHENSIVE TEXT: p. 2-18, Appendix A, front inside cover.
BUSINESS ENTITIES TEXT: pp. 15-16, 15-17, Appendix A, front inside cover.
ADVANCED BUSINESS ENTITIES TEXT: Appendix A, front inside cover.
CODE: §§ 1(i)(1) and (2).

Marriage Penalty

The social undesirability of forcing certain couples to pay higher income taxes if they get married than if they remained single needs no further comment. Under RRA of 2001, a solution to this problem was enacted, but it was to be phased in over a 5-year period—beginning in 2005 and not ending until 2009. JGTRRA makes the implementation of the solution effective January 1, 2003.

The solution to the marriage penalty is two-pronged. First, the 15% tax bracket applicable to married taxpayers is extended to twice (200%) that applicable to single persons. Since the 15% tax rate for singles currently goes to taxable income of $28,400, for married persons it will now reach $56,800 (200% X $28,400). As the previous 15% bracket for married persons filing jointly ended at $47,450, this means an extra $9,350 ($56,800 – $47,450) that is taxed at 15% and not at 25% (the next higher bracket). The overall saving is $935 [($9,350 X 25%) – ($9,350 X 15%)].

The second prong of the solution is to allow married persons twice (200%) the standard deduction available to singles. Thus, the 2003 standard deduction for married persons becomes $9.500 [200% X $4,750 (the standard deduction available to singles in 2003)]. When this is compared with the prior standard deduction for married persons of $7,950, the increase is $1,550 ($9,500 – $7,950).

> Example. Joseph and Brianna each has AGI of $55,000, no dependents, and claims the standard deduction. If they are single, each has taxable income of $47,200 ($55,000 – $4,750 – $3,050). Under the tax rate schedule for single taxpayers, each has a tax of $8,610 [$3,910 + 25%($47,200 – $28,400)]. If they are married and file a joint return, their taxable income is $94,400 ($55,000 + $55,000 – $9,500 – $3,050 – $3,050). Under the tax rate schedule for married filing jointly, their tax will be $17,220 [$7,820 + 25%($94,400 – $56,800)]. As the combined tax on filing as single taxpayers, $17,220 ($8,610 X 2) is no less than their tax as married persons filing jointly, $17,220, the marriage penalty has disappeared. See Appendix A of this Supplement for the Tax Rate Schedules for 2003 as revised by JGTRRA.

At least during its effective period, JGTRRA modifies the rate schedule for married persons filing separately. The first two brackets conform to those available to single persons. The standard deduction to be used is that available to single taxpayers.

The marriage penalty changes made by JGTRRA sunset after two years. Starting in 2005, the variance between single and married taxpayers drops from 200% to 180%. At this point, however, the previously scheduled phase-in of RRA of 2001 kicks in to gradually provide relief by 2009.

This partial fix of the marriage penalty will prove to be a boon for many couples. Particularly in households where only one of the spouses is employed, it enhances the "marriage bonus." This goes back to the original income-splitting advantages built into the joint return rates. Recalling the new approach to dividends, the lowering of the tax on net capital gain and the increase in the child tax credit (see below), it can be said that married investors with children will fare well under JGTRRA.

INDIVIDUAL TEXT: pp. 3-7, 3-28, 3-29.
COMPREHENSIVE TEXT: pp. 2-7, 2-28, 2-29.
BUSINESS ENTITIES TEXT: pp. 15-7, 15-25.
ADVANCED BUSINESS ENTITIES TEXT: Appendix A, front inside cover.
CODE: §§ 1(f)(8) and 63(c).

Child Tax Credit

JGTRRA accelerates the scheduled increases in the child tax credit enacted by RRA of 2001. Instead of waiting until 2010, the jump to $1,000 (from $600) becomes effective for 2003 and 2004. Unfortunately, the increase to $1,000 sunsets after 2004. At that stage, the RRA of 2001 phase-in takes over, and the credit is reduced to $700. Ultimately, however, it will again reach $1,000 by 2010. As this change is very popular, there is good reason to expect that the $1,000 will become permanent and the sunset provision cancelled.

As previously noted, the IRS has been directed to begin advance payments to qualified taxpayers. The payments, to begin in July of 2003, will be in an amount equal to $400 per child and will be based on the information contained in a taxpayer's 2002 tax return.

The advance payment procedure will cause some taxpayer confusion. Mistakes will occur, and some taxpayers who no longer qualify for the credit (e.g., the child is not a dependent anymore) may receive an advance payment. It remains to be seen whether the IRS will be forgiving of such mistakes and not compel the taxpayer to repay the refund received. In other cases where no advance payment is received but the taxpayer is entitled to the credit, it should be claimed on the return filed for 2003.

Because the child tax credit is a refundable credit only to the extent of 10% of earned income in excess of $10,500, it precludes approximately 6.5 million low-income families from obtaining any benefit. Consequently, the parents of one out of every six children under the age of 17 are ineligible for the credit and will not receive any payment. A provision in the original bill that would have expanded the reach of the credit was deleted from the final version. The reason for the deletion was to keep JGTRRA within the targeted $350 billion of revenue loss. Some

members of Congress regret the deletion since it denies funds to those who need them the most. Others in Congress question the propriety of giving tax relief to those who don't pay income tax.

After the passage of JGTRRA, several members of the U.S. Senate had serious reservations over the omission of so many low-income families from the advance payment procedure. In a separate bill passed on June 11, 2003, the Senate increased the refundable portion of the child tax credit to 15% of a taxpayer's earned income in excess of $10,500. Also included in this extension was the combat pay received by members of the military, even though such pay is not subject to tax. Shortly thereafter, the House enacted H.R. 1308 to accomplish the same objective as the Senate bill. Since the two bills are too different to allow quick reconciliation, H.R. 1308 has been referred to a joint conference.

The advance payment procedure for the child tax credit is intended to make funds available to boost consumer spending. This, in turn, helps stimulate the economy.

INDIVIDUAL TEXT: pp. 3-17, 13-22.
COMPREHENSIVE TEXT: pp. 2-17, 11-22.
BUSINESS ENTITIES TEXT: pp. 15-53, 15-54.
CODE: §§ 24(a)(2) and 6429.

Bonus Depreciation

JGTRRA amends § 168(k) to allow an additional first-year deduction equal to 50% of the adjusted basis of qualified property placed in service after May 5, 2003, and before January 1, 2005. Any written binding contract for the acquisition of such property must not be in effect before May 6, 2003.

Bonus depreciation is applicable to business assets with a MACRS life of 20 years or less, leasehold improvements, and certain computer software. However, the property acquired must be new. Bonus depreciation is in addition to any other depreciation that would otherwise be available.

> Example. On June 2, 2003, Hannah acquires a new depreciable asset for use in her business. The asset cost $100,000 and has a class life of 5 years. (Assume Hannah has used her § 179 expensing allowance on property with longer class lives.) As to this asset, Hannah's cost recovery deduction for 2003 is $60,000, determined as follows:

50% bonus (50% X $100,000)	$50,000
MACRS cost recovery [20% X ($100,000 – $50,000)]	10,000
Total	$60,000

Bonus depreciation is an election-out provision; taxpayers must claim the full amount [50% or 30% (see below)] or elect out entirely.

Example. Assume the same facts as in the previous example except that Hannah has an NOL carryover from a prior year that will expire in 2003. By electing out of bonus depreciation, her depreciation on the acquired asset becomes $20,000 (20% X $100,000). This results in a $40,000 less deduction ($60,000 – $20,000) and increases Hannah's profit potential by a like amount. [Note: It can be presumed that Hannah would not expense any property under § 179 for year 2003.]

The 50% bonus provided by JGTRRA does not eliminate the 30% allowed under the Job Creation and Worker Assistance Act of 2002 (JCWAA). In fact, JGTRRA extends the expiration date of the 30% provision from September 11, 2004, to December 31, 2004. Although a taxpayer cannot use both the 30% and 50% bonus allowances on the same assets, the election of either on a class-by-class basis is permissible.

The maximum bonus depreciation allowed on automobiles was set by JCWAA of 2002 at $4,600. JGTRRA amends § 168(k)(4)(D) to raise this figure to $7,650.

INDIVIDUAL TEXT: p. 8-7.
COMPREHENSIVE TEXT: p. 7-7.
BUSINESS ENTITIES TEXT: pp. 4-24, 4-25, 4-31.
CODE: § 168(k).

Section 179 Expensing

Section 179 allows the expensing of tangible property purchased by a taxpayer for use in a trade or business that normally would be capitalized. Expensing the acquisition cost avoids the prolonged process of cost recovery through depreciation. JGTRRA makes the following changes to § 179:

- The maximum amount that can be expensed is raised from $25,000 to $100,000.
- The amount of acquisition cost above which a phase-out begins is raised from $200,000 to $400,000.
- The increased dollar amounts noted above are to be indexed for inflation for tax years 2004 and 2005.
- Off-the-shelf computer software is now eligible for §179 expensing.
- Taxpayers may revoke the election to expense without IRS consent. Previously, such consent was necessary.

These changes are effective for years 2003 through 2005.

The interplay between § 179 bonus and regular MACRS cost recovery is illustrated below.

Example. On May 9, Nicholas purchased a depreciable asset for use in his business. The asset cost $150,000 and had a class life of 5 years. In assessing the effect of the JGTRRA changes, contrast the results depending on whether the purchase occurred in 2002 or 2003.

	Year of Purchase	
	2002	2003
Section 179 expensing	$25,000	$100,000
Bonus—		
30% X ($150,000 – $25,000)	37,500	
50% X ($150,000 – $100,000)		25,000
MACRS—		
20% X ($150,000 – $25,000 – $37,500)	17,500	
20% X ($150,000 – $100,000 – $25,000)		5,000
Total	$80,000	$130,000

The obvious advantage to the 2003 assumption is an extra write-off of $50,000 ($130,000 – $80,000) in the year of purchase. Regarding the 2002 assumption, Nicholas is stuck with $70,000 ($150,000 – $80,000) of unrecovered cost, which must be recouped through conventional MACRS depreciation procedures.

Example. In 2003, Hailey purchased depreciable assets for use in her business in the amount of $180,000. Of these assets, $100,000 worth are 10-year class life while $80,000 are 5-year class life. Based on the premise that it is desirable for her to accelerate deductions, Hailey's choice is clear! Pick the 10-year class life property for expensing under § 179. The remaining $80,000 yields less postponed cost recovery due to the shorter class life.

The selection process will have to take into account whether brand new or used property is involved. Expensing applies to both, but bonus depreciation can be used only as to new property.

The JGTRRA increase in the acquisition cost limit will allow more businesses to qualify for expensing. The effect of amending § 179(b)(2) to raise $200,000 to $400,000 is illustrated below.

Example. Dwayne places $410,000 of § 179 property in service. Presuming the old $200,000 limit had not been changed, no expensing would be possible. The excess investment over $200,000, or $210,000, would have eliminated the $100,000 maximum allowed. Under the new $400,000 limit, a reduction of only $10,000 ($410,000 – $400,000) occurs. As a result, Dwayne may expense $90,000 ($100,000 – $10,000) of the $410,000 [Note: It is assumed that the taxable income rule of § 179(b)(3) is satisfied.]

The objective of the JGTRRA changes to both bonus depreciation and § 179 expensing is the economic consideration of the encouragement of small business. Although every business will

benefit from these changes, the greatest impact will be on the smaller concerns. It is here where the major growth in jobs is expected to occur.

INDIVIDUAL TEXT: pp. 8-12 to 8-14.
COMPREHENSIVE TEXT: pp. 7-12 to 7-14.
BUSINESS ENTITIES TEXT: pp. 4-28 to 4-30.
CODE: § 179.

Other Changes

The JGTRRA changes not previously mentioned are summarized below:

- The § 531 tax rate is reduced to 15% of accumulated taxable income.
- The § 541 tax rate is reduced to 15% of undistributed personal holding company income.
- The collapsible corporation provision (§ 341) is repealed.
- The 25% of corporate estimated tax payments due on September 15, 2003, is postponed until October 1, 2003.
- The AMT exemption available to single taxpayers is raised to $40,250 (from $35,750) and that for married persons to $58,000 (from $49,000). This change sunsets after 2004.

The §§ 531 and 541 reductions to 15% is somewhat unusual since the rates usually are set to equal the highest applicable to individuals (now 35%). With the new favorable treatment of dividend distributions and the lower tax rates imposed on individuals, the corporate form has lost some of its luster as a means of sheltering income. Perhaps Congress concluded that the corporate accumulation device is no longer enough of a problem to warrant a penalty tax any higher than 15%.

The modest AMT change is a band-aid solution to what is becoming a tax minefield for an ever-increasing number of unintended victims. Although the conceptual justification for the AMT may have been sound, is it accomplishing its goal? Indications are that it is not, and that it is causing more harm than good. In any event, what is needed is for Congress to make an in-depth evaluation of the current AMT provisions. Based on this evaluation, substantial changes should be made. Taxpayers who are caught in the AMT malaise are deserving of more than piecemeal relief!

INDIVIDUAL TEXT: pp. 12-8 to 12-9, 20-14, 20-19.
CORPORATIONS TEXT: pp. 2-26, 2-27, 2-39, 6-13, 6-21, 13-14.
COMPREHENSIVE TEXT: pp. 14-8, 16-28, 16-34.
BUSINESS ENTITIES TEXT: pp. 9-25, 13-32, 14-13.
CODE: §§ 55(d), 341, 531, 541, 6655.

Correct

APPENDIX A

2003 Tax Rate Schedules. The 2003 tax rate schedules are as follows:

Single [§1(c)]:

If taxable income is:	The tax is:
Not over $7,000	10% of taxable income.
Over $7,000 but not over $28,400	$700.00, plus 15% of the excess over $7,000.
Over $28,400 but not over $68,800	$3,910.00, plus 25% of the excess over $28,400.
Over $68,800 but not over $143,500 . . .	$14,010.00, plus 28% of the excess over $68,800.
Over $143,500 but not over $311,950 . .	$34,926.00, plus 33% of the excess over $143,500.
Over $311,950	$90,514.50, plus 35% of the excess over $311,950.

Head of Household [§1(b)]:

If taxable income is:	The tax is:
Not over $10,000	10% of taxable income.
Over $10,000 but not over $38,050	$1,000.00, plus 15% of the excess over $10,000.
Over $38,050 but not over $98,250	$5,207.50, plus 25% of the excess over $38,050.
Over $98,250 but not over $159,100 . . .	$20,257.50 plus 28% of the excess over $98,250.
Over $159,100 but not over $311,950 . .	$37,295.50, plus 33% of the excess over $159,100.
Over $311,950	$87,736.00, plus 35% of the excess over $311,950.

Married, Filing Joint and Surviving Spouse [§1(a)]:

If taxable income is:	The tax is:
Not over $14,000	10% of taxable income.
Over $14,000 but not over $56,800	$1,400.00, plus 15% of the excess over $14,000.
Over $56,800 but not over $114,650 . . .	$7,820.00, plus 25% of the excess over $56,800.
Over $114,650 but not over $174,700 . .	$22,282.50, plus 28% of the excess over $114,650.
Over $174,700 but not over $311,950 . .	$39,096.50, plus 33% of the excess over $174,700.
Over $311,950	$84,389.00, plus 35% of the excess over $311,950.

Married, Filing Separate [§1(d)]:

If taxable income is:	The tax is:
Not over $7,000	10% of taxable income.
Over $7,000 but not over $28,400	$700.00, plus 15% of the excess over $7,000.
Over $28,400 but not over $57,325	$3,910.00, plus 25% of the excess over $28,400.
Over $57,325 but not over $87,350	$11,141.25, plus 28% of the excess over $57,325.
Over $87,350 but not over $155,975 . . .	$19,548.25, plus 33% of the excess over $87,350.
Over $155,975	$42,194.50, plus 35% of the excess over $155,975.

Estates and Trusts [§1(e)]:

If taxable income is:	The tax is:
Not over $1,900	15% of taxable income.
Over $1,900 but not over $4,500	$285.00, plus 25% of the excess over $1,900.
Over $4,500 but not over $6,850	$935.00, plus 28% of the excess over $4,500.
Over $6,850 but not over $9,350	$1,593.00, plus 33% of the excess over $6,850.
Over $9,350	$2,418.00, plus 35% of the excess over $9,350.

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ISBN 0-324-22681-0